

# **John Tolfree Health System Corporation**

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**Financial Report  
with Additional Information  
March 31, 2005**

# Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended.

John Tolfree Health System

Local Government Type <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Government Name <b>West Branch Regional Medical Center</b>	County <b>Ogemaw</b>
Audit Date <b>3/31/05</b>	Opinion Date <b>6/15/05</b>	Date Accountant Report Submitted to State: <b>8/3/05</b>	

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

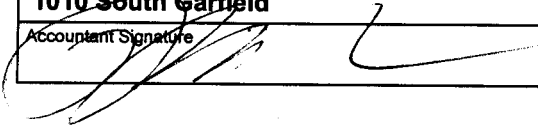
We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- ☐ Yes ☒ No 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.
- ☐ Yes ☒ No 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).
- ☐ Yes ☒ No 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended).
- ☐ Yes ☒ No 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.
- ☐ Yes ☒ No 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]).
- ☐ Yes ☒ No 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.
- ☐ Yes ☒ No 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).
- ☐ Yes ☒ No 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).
- ☐ Yes ☒ No 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

We have enclosed the following:

	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	✓		
Reports on individual federal financial assistance programs (program audits).			✓
Single Audit Reports (ASLGU).			✓

Certified Public Accountant (Firm Name) <b>Plante &amp; Moran, PLLC</b>			
Street Address <b>1010 South Garfield</b>		City <b>Traverse City</b>	State <b>MI</b>
Accountant Signature 		ZIP <b>49682</b>	Date <b>8/3/05</b>

# John Tolfree Health System Corporation

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## Independent Auditor's Report

To the Board of Trustees  
John Tolfree Health System Corporation

We have audited the accompanying financial statements of the business-type activities and the aggregate discretely presented component units of John Tolfree Health System Corporation (a component unit of the City of West Branch) as of and for the years ended March 31, 2005 and 2004. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these combined financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and the aggregate discretely presented component units of John Tolfree Health System Corporation at March 31, 2005 and 2004 and the respective changes in financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the financial statements, John Tolfree Health System Corporation has changed its method of presenting component units.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 15, 2005 on our consideration of John Tolfree Health System Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

To the Board of Trustees  
John Tolfree Health System Corporation

The accompanying financial statements do not present a management's discussion and analysis, which would be an analysis of the financial performance for the year. The Governmental Accounting Standards Board has determined that this analysis is necessary to supplement, although not required to be part of, the basic financial statements.

*Plante & Moran, PLLC*

June 15, 2005

# John Tolfree Health System Corporation

## Balance Sheet

	March 31			
	2005		2004	
	Hospital	Component Units	Hospital	Component Units
<b>Assets</b>				
<b>Current Assets</b>				
Cash and cash equivalents (Note 3)	\$ 2,834,220	\$ 216,731	\$ 2,224,343	\$ 469,491
Accounts receivable (Note 4)	3,801,723	397,757	3,864,219	482,936
Due from affiliates	281,326	200	328,816	29,060
Cost report settlements receivable	771,562	-	632,400	-
Prepaid expenses and other	495,559	55,421	903,156	56,987
Inventory	1,112,043	-	1,004,535	-
Total current assets	9,296,433	670,109	8,957,469	1,038,474
<b>Assets Limited as to Use</b> (Note 3)	5,945,534	2,081,818	5,850,548	2,020,110
<b>Property and Equipment</b> (Note 6)	19,031,434	9,890,338	20,133,678	9,440,984
<b>Deferred Charges</b>	302,495	-	318,846	-
Total assets	<u>\$ 34,575,896</u>	<u>\$12,642,265</u>	<u>\$ 35,260,541</u>	<u>\$12,499,568</u>
<b>Liabilities and Net Assets</b>				
<b>Current Liabilities</b>				
Current portion of long-term debt (Note 7)	\$ 503,012	\$ 68,925	\$ 485,533	\$ 66,558
Accounts payable	1,999,343	69,182	1,422,423	65,774
Due to affiliates	200	281,326	29,060	328,816
Accrued liabilities	1,676,013	22,413	1,434,787	20,422
Total current liabilities	4,178,568	441,846	3,371,803	481,570
<b>Long-term Debt</b> (Note 7)	16,640,870	1,004,404	17,137,418	1,072,698
<b>Deferred Revenue</b> (Note 8)	-	3,993,450	-	4,110,332
Total liabilities	20,819,438	5,439,700	20,509,221	5,664,600
<b>Net Assets</b>				
Invested in capital assets - Net of related debt	1,887,552	8,817,009	2,510,727	8,301,728
Unrestricted	11,868,906	(1,614,444)	12,240,593	(1,466,760)
Total net assets	13,756,458	7,202,565	14,751,320	6,834,968
Total liabilities and net assets	<u>\$ 34,575,896</u>	<u>\$12,642,265</u>	<u>\$ 35,260,541</u>	<u>\$12,499,568</u>

# John Tolfree Health System Corporation

## Statement of Revenue, Expenses, and Changes in Net Assets

	Year Ended March 31			
	2005		2004	
	Hospital	Component Units	Hospital	Component Units
<b>Operating Revenue</b>				
Net patient service revenue	\$ 36,900,285	\$ 2,510,318	\$ 33,412,854	\$ 2,053,749
Other operating revenue	741,968	1,531,048	1,191,098	1,503,590
Total operating revenue	37,642,253	4,041,366	34,603,952	3,557,339
<b>Operating Expenses</b>				
Salaries and wages	12,491,357	1,090,800	11,787,583	969,845
Employee benefits and payroll taxes	4,569,338	374,400	3,419,746	279,763
Supplies and other	10,941,581	1,096,827	10,118,057	899,738
Drugs	4,599,301	105,150	5,130,361	101,667
Professional and purchased services	3,284,310	564,718	2,029,015	480,926
Depreciation and amortization	1,930,905	532,041	2,141,044	492,663
Total operating expenses	37,816,792	3,763,936	34,625,806	3,224,602
<b>Income (Loss) from Operations</b>	(174,539)	277,430	(21,854)	332,737
<b>Nonoperating Revenue (Expense)</b>				
Interest income	141,782	51,836	215,899	14,370
Contributions	12,898	77,704	-	82,884
Interest expense	(975,003)	(39,373)	(997,043)	(52,492)
Net nonoperating revenue (expense)	(820,323)	90,167	(781,144)	44,762
<b>Increase (Decrease) in Net Assets</b>	(994,862)	367,597	(802,998)	377,499
<b>Net Assets - Beginning of year</b>	14,751,320	6,834,968	15,554,318	6,457,469
<b>Net Assets - End of year</b>	<u>\$ 13,756,458</u>	<u>\$ 7,202,565</u>	<u>\$ 14,751,320</u>	<u>\$ 6,834,968</u>

# John Tolfree Health System Corporation

## Statement of Cash Flows

	Year Ended March 31			
	2005		2004	
	Hospital	Component Units	Hospital	Component Units
<b>Cash Flows from Operating Activities</b>				
Cash received from patients and third-party payors	\$ 36,823,619	\$ 2,624,357	\$ 31,741,617	\$ 2,050,668
Cash payments to suppliers for services and goods	(34,796,512)	(3,272,420)	(33,084,643)	(2,724,250)
Other receipts from operations	789,458	1,376,899	1,173,019	1,287,863
Net cash provided by (used in) operating activities	2,816,565	728,836	(170,007)	614,281
<b>Cash Flows from Noncapital Financing Activities - Donations and memorials</b>	12,898	114,971	-	181,730
<b>Cash Flows from Investing Activities</b>				
Interest received	141,782	51,836	215,899	14,370
Increase (decrease) in investments	(1,492,968)	469,692	2,780,247	(249,088)
Net cash provided by (used in) investing activities	(1,351,186)	521,528	2,996,146	(234,718)
<b>Cash Flows from Capital and Related Financing Activities</b>				
Acquisition and construction of capital assets	(812,310)	(981,395)	(635,929)	(465,800)
Interest paid on long-term debt	(975,003)	(39,373)	(997,043)	(52,492)
Principal payments on long-term debt	(479,069)	(65,927)	(457,028)	(52,807)
Net cash used in capital and related financing activities	(2,266,382)	(1,086,695)	(2,090,000)	(571,099)
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	(788,105)	278,640	736,139	(9,806)
<b>Cash and Cash Equivalents - Beginning of year</b>	5,612,891	731,087	4,876,752	740,893
<b>Cash and Cash Equivalents - End of year</b>	<u>\$ 4,824,786</u>	<u>\$ 1,009,727</u>	<u>\$ 5,612,891</u>	<u>\$ 731,087</u>
<b>Composed of</b>				
Cash and cash equivalents	\$ 2,834,220	\$ 216,731	\$ 2,224,343	\$ 469,491
Assets limited as to use	1,990,566	792,996	3,388,548	261,596
Total	<u>\$ 4,824,786</u>	<u>\$ 1,009,727</u>	<u>\$ 5,612,891</u>	<u>\$ 731,087</u>



# John Tolfree Health System Corporation

## Statement of Cash Flows (Continued)

	Year Ended March 31			
	2005		2004	
	Hospital	Component Units	Hospital	Component Units
<b>Reconciliation of Income (Loss) from Operations to Net Cash from Operating Activities</b>				
Income (loss) from operations	\$ (174,539)	\$ 277,430	\$ (21,854)	\$ 332,737
Adjustments to reconcile income (loss) from operations to net cash from operating activities:				
Depreciation and amortization	1,930,905	532,041	2,141,043	492,663
Noncash rental income	-	(116,882)	-	(116,882)
Contributions included in operations	-	(37,267)	-	(98,846)
Provision for doubtful accounts	738,750	40,051	794,020	41,194
Changes in assets and liabilities:				
Patient accounts receivable	(676,254)	45,128	(2,459,055)	(46,390)
Due from affiliates	47,490	28,860	(18,079)	2,915
Third-party settlement receivable	(139,162)	-	117,600	-
Inventories	(107,508)	-	105,174	-
Other current assets	407,597	1,566	(75,473)	(16,754)
Accounts payable	576,920	3,408	(188,795)	(1,916)
Due from affiliates	(28,860)	(47,490)	(2,915)	18,079
Accrued expenses	241,226	1,991	(437,871)	8,280
Third-party settlement payable	-	-	(123,802)	(799)
Net cash provided by (used in) operating activities	<u>\$ 2,816,565</u>	<u>\$ 728,836</u>	<u>\$ (170,007)</u>	<u>\$ 614,281</u>

During the years ended March 31, 2005 and 2004, the Corporation recognized revenue of \$116,882 related to a deferred rental arrangement (see Note 8).

# John Tolfree Health System Corporation

## Notes to Financial Statements March 31, 2005 and 2004

### Note 1 - Nature of Business and Significant Accounting Policies

**Reporting Entity** - John Tolfree Health System Corporation (the "Hospital") provides inpatient and outpatient services primarily to the citizens of Ogemaw County and four adjacent counties. The Hospital is located in West Branch, Michigan. The Hospital is a municipal corporation whose board is appointed by the City Council of the City of West Branch. For this reason, the Hospital is considered to be a component unit of the City of West Branch (the "City") and is included as a discretely presented component unit in the basic financial statements of the City.

The Hospital is the sole member of three related entities: Medical Arts Center (the "Center"); Hospice of Helping Hands, Inc. (Hospice); and Tolfree Foundation (the "Foundation"). All are not-for-profit organizations or municipal corporations and are exempt from income taxes. The Center provides mammography, ultrasound, and cardiology services to area residents. Hospice provides home care services to the terminally ill. The Foundation engages in fund-raising activities on behalf of the Hospital.

**Basis of Presentation** - The financial statements include the accounts of John Tolfree Health System Corporation and its component units (collectively referred to as the "Corporation"): Medical Arts Center, Hospice of Helping Hands, Inc., and Tolfree Foundation. The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, issued June 1999. The Corporation follows the "business-type" activities reporting requirements of GASB Statement No. 34 that provides a comprehensive one-line look at the Corporation's financial activities. The Corporation has elected not to apply provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB).

**Proprietary Fund Accounting** - The Corporation utilizes the proprietary fund method of accounting whereby revenue and expenses are recognized on the full accrual basis. Substantially all revenue and expenses are subject to accrual.

**Cash and Cash Equivalents** - Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less.

**Investments** - Investments are stated at market, plus accrued interest.

**Inventories** - Inventories are stated at the lower of cost, determined by the first-in, first-out method, or market.

# **John Tolfree Health System Corporation**

## **Notes to Financial Statements March 31, 2005 and 2004**

### **Note 1 - Nature of Business and Significant Accounting Policies (Continued)**

**Assets Limited as to Use** - Assets limited as to use include assets set aside by the board of trustees for future capital improvements, over which the board retains control and may at its discretion subsequently use for other purposes, and assets held by trustees in accordance with debt arrangements.

**Property and Equipment** - Property and equipment acquisitions are recorded at cost. Donations of property and equipment are recorded at fair market value at the date of donation. Depreciation is computed on the straight-line basis over the estimated useful lives of the assets. Costs of maintenance and repairs are charged to expense when incurred.

**Deferred Charges** - Deferred charges represent bond issue costs that are being amortized over the period the respective bonds are outstanding using the interest method.

**Net Assets** - Net assets of the Hospital are classified in two components. Net assets invested in capital assets - net of related debt consist of capital assets net of accumulated depreciation and are reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets - net of related debt.

**Net Patient Service Revenue** - Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactively calculated adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined (see Note 4).

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

**Statement of Revenue and Expenses** - For the purpose of display, transactions deemed by management to be ongoing, major, or central to the provision of health care services are reported as revenue and expenses. Peripheral or incidental transactions are reported as gains and losses.

# **John Tolfree Health System Corporation**

## **Notes to Financial Statements March 31, 2005 and 2004**

### **Note 1 - Nature of Business and Significant Accounting Policies (Continued)**

**Compensated Absences** - Vacation and sick pay are charged to operations when earned. Unused and earned benefits are recorded as a current liability in the financial statements.

**Pension Plan** - The Hospital has a defined benefit pension plan covering all employees who work at least 1,000 hours a year after 30 months of service. The Hospital's funding policy is to contribute the amount necessary to provide assets sufficient to meet the benefits of plan participants, as determined by an independent actuary.

**Professional Liability Insurance** - The Hospital accrues the ultimate expense, including litigation and settlement expense, for incidents occurring during the year, as well as the estimate of those claims that have not been reported at year end (see Note 10).

**Charity Care** - The Corporation provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Charity care amounts to less than 1 percent of patients served.

**Tax Status** - The Corporation is tax exempt under the Internal Revenue Code, and, accordingly, no tax provision is reflected in the financial statements.

### **Note 2 - Change in Presentation**

The Corporation changed the method by which it is presenting its component units during 2005 from a "blended" presentation to a "discrete" presentation for all disclosures with the 2005 financial statements. The change in presentation was in order to comply with the provisions of Government Accounting Standards Board (GASB) Statements No. 14, *The Financial Reporting Entity*, and No. 39, *Determining Whether Certain Organizations are Component Units*, issued by the Governmental Accounting Standards Board. The 2004 financial statements have been restated to reflect the discrete presentation of the component units.

# John Tolfree Health System Corporation

## Notes to Financial Statements March 31, 2005 and 2004

### Note 3 - Deposits and Investments

The Corporation's deposits and investments are included in the balance sheet under the following classifications:

	2005		2004	
	Hospital	Component Units	Hospital	Component Units
Cash and cash equivalents	\$ 2,834,220	\$ 216,731	\$ 2,224,343	\$ 469,491
Assets limited as to use	5,945,534	2,081,818	5,850,548	2,020,110
Total	<u>\$ 8,779,754</u>	<u>\$ 2,298,549</u>	<u>\$ 8,074,891</u>	<u>\$ 2,489,601</u>
Bank deposits	\$ 6,337,318	\$ 2,004,621	\$ 5,612,141	\$ 2,228,155
Investments	2,441,686	293,748	2,462,000	261,266
Petty cash and cash on hand	750	180	750	180
Total	<u>\$ 8,779,754</u>	<u>\$ 2,298,549</u>	<u>\$ 8,074,891</u>	<u>\$ 2,489,601</u>

**Deposits** - The bank balance of the Hospital's deposits at March 31, 2005 is \$6,800,869, of which \$300,030 is covered by federal depository insurance. The remaining amounts were uninsured and uncollateralized. The Hospital believes that due to the dollar amounts of cash deposits and the limits of FDIC insurance, it is impractical to insure all bank deposits. As a result, the Corporation evaluates each financial institution with which it deposits Corporation funds and assesses the level of risk of each institution; only those institutions with an acceptable estimated risk level are used as depositories.

The component units' deposits had a bank balance at March 31, 2005 of \$2,107,062, of which \$760,762 is covered by federal depository insurance. The remaining amounts were uninsured and uncollateralized.

**Investments** - The Corporation is authorized under the laws of the State of Michigan to invest surplus monies (of nonpension funds) in U.S. bonds and notes, certain commercial paper, U.S. government repurchase agreements, bankers' acceptances, mutual funds, and investment pools that are composed of authorized investment vehicles.

# John Tolfree Health System Corporation

## Notes to Financial Statements March 31, 2005 and 2004

### Note 3 - Deposits and Investments (Continued)

All of the Corporation's investments are categorized as Risk Category 1. Risk Category 1 includes investments that meet any one of the following criteria:

- a. Insured
- b. Registered
- c. Held by the Corporation or its agent

Risk Categories 2 and 3 include investments that are neither insured nor registered. Category 2 includes investments that are held by the counterparty's trust department (or agent) in the Corporation's name. Category 3 includes investments held by:

- a. The counterparty or
- b. The counterparty's trust department (or agency) but not in the Corporation's name

2005	Category			Current Value
	1	2	3	
U.S. government obligations	\$ 1,247,846	\$ -	\$ -	\$ 1,247,846
Bank management pool	-	-	-	1,193,840
Total investments	<u>\$ 1,247,846</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,441,686</u>
2004				
U.S. government obligations	\$ 1,262,879	\$ -	\$ -	\$ 1,262,879
Bank management pool	-	-	-	1,199,121
Total investments	<u>\$ 1,262,879</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,462,000</u>

The bank investment pools are not categorized because they are not evidenced by securities that exist in physical or book entry form. Management believes the investments in the funds comply with the investment authority noted above. The bank investment pools are regulated by the Michigan Banking Act.

# John Tolfree Health System Corporation

## Notes to Financial Statements March 31, 2005 and 2004

### Note 3 - Deposits and Investments (Continued)

**Assets Limited as to Use** - The composition of assets limited as to use is set forth below:

	2005		2004	
	Hospital	Component Units	Hospital	Component Units
Designated by board for capital improvements	\$ 3,557,174	\$ 2,081,818	\$ 3,510,994	\$ 2,020,110
Held by trustee, under bond agreement	<u>2,388,360</u>	<u>-</u>	<u>2,339,554</u>	<u>-</u>
Total assets limited as to use	<u>\$ 5,945,534</u>	<u>\$ 2,081,818</u>	<u>\$ 5,850,548</u>	<u>\$ 2,020,110</u>

Assets held under the bond indenture agreements are composed of debt service funds.

### Note 4 - Accounts Receivable

The detail of accounts receivable is presented below:

	2005		2004	
	Hospital	Component Units	Hospital	Component Units
Patient accounts receivable	\$ 10,983,525	\$ 416,032	\$ 13,241,974	\$ 588,912
Less:				
Allowance for uncollectible accounts	1,566,694	62,585	2,089,043	131,500
Allowance for contractual adjustments and interim payment advances	<u>6,206,636</u>	<u>75,710</u>	<u>7,291,625</u>	<u>82,918</u>
Patient accounts receivable - Net	3,210,195	277,737	3,861,306	374,494
Other accounts receivable	<u>591,528</u>	<u>120,020</u>	<u>2,913</u>	<u>108,442</u>
Total accounts receivable	<u>\$ 3,801,723</u>	<u>\$ 397,757</u>	<u>\$ 3,864,219</u>	<u>\$ 482,936</u>

# John Tolfree Health System Corporation

## Notes to Financial Statements March 31, 2005 and 2004

### Note 4 - Accounts Receivable (Continued)

Accounts receivable for patients, insurance companies, and governmental agencies are based on gross charges. An allowance for uncollectible accounts is established on an aggregate basis by using historical loss rate factors applied to unpaid accounts based on aging. Loss rate factors are based on historical loss experience and adjusted for economic conditions and other trends affecting the Hospital's ability to collect outstanding amounts. Uncollectible amounts are written off against the allowance for uncollectible accounts in the period they are deemed to be uncollectible. The allowance for contractual adjustments and interim payment advances is based on expected payment rates from payors using current reimbursement methodologies. This amount also includes amounts received as interim payments against unpaid claims by certain payors.

The Corporation grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements.

The mix of receivables from patients and third-party payors was as follows:

	2005		2004	
	Component		Component	
	Hospital	Units	Hospital	Units
Medicare	39%	33%	37%	46%
Medicaid	13%	21%	18%	18%
Blue Cross	20%	9%	17%	15%
Commercial	17%	19%	15%	11%
Patients	11%	18%	13%	10%
Total	100%	100%	100%	100%

### Note 5 - Cost Report Settlements

The Corporation has agreements with third-party payors that provide for reimbursement to the Corporation at amounts different from its established rates. A summary of the basis of reimbursement is as follows:

**Medicare** - Inpatient acute-care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. All outpatient services are paid based on an established fee-for-service methodology subject to hold-harmless provisions.



# **John Tolfree Health System Corporation**

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## **Notes to Financial Statements March 31, 2005 and 2004**

### **Note 5 - Cost Report Settlements (Continued)**

**Medicaid** - Inpatient, acute-care services rendered to Medicaid program beneficiaries are also paid at prospectively determined rates per discharge. Capital costs relating to Medicaid patients are paid on a cost-reimbursement method. The Hospital is reimbursed for outpatient services on an established fee-for-service methodology.

**Blue Cross** - Inpatient, acute-care services rendered to Blue Cross subscribers are also paid at prospectively determined rates per discharge. Outpatient services are reimbursed on an established fee-for-service methodology.

Cost report settlements result from the adjustment of interim payments to final reimbursement under these programs and are subject to audit by fiscal intermediaries. Although these audits may result in some changes in these amounts, they are not expected to have a material effect on the accompanying financial statements.

# John Tolfree Health System Corporation

## Notes to Combined Financial Statements March 31, 2005 and 2004

### Note 6 - Property and Equipment

Capital asset activity for the year ended March 31, 2005 was as follows:

	Hospital				Depreciable Life - Years
	2004	Additions	Transfers	Retirements	2005
Land and land improvements	\$ 569,425	\$ -	\$ -	\$ -	\$ 569,425
Building	9,692,162	-	-	-	9,692,162
Equipment	17,360,508	812,310	-	(749,779)	17,423,039
Construction in progress	58,013	-	-	-	58,013
Total	27,680,108	812,310	-	(749,779)	27,742,639
Less accumulated depreciation:					
Land and land improvements	174,334	38,509	-	-	212,843
Building	1,418,135	284,338	-	-	1,702,473
Equipment	5,953,961	1,591,707	-	(749,779)	6,795,889
Total	7,546,430	1,914,554	-	(749,779)	8,711,205
Net carrying amount	\$ 20,133,678	\$ (1,102,244)	\$ -	\$ -	\$ 19,031,434

# John Tolfree Health System Corporation

## Notes to Combined Financial Statements March 31, 2005 and 2004

### Note 6 - Property and Equipment (Continued)

Capital asset activity for the year ended March 31, 2005 was as follows:

	Component Units				Depreciable Life - Years
	2004	Additions	Transfers	Retirements	2005
Land and land improvements	\$ 626,682	\$ -	\$ -	(4,750)	\$ 621,932
Building	9,698,290	22,029	-	(51,206)	9,669,113
Equipment	2,507,127	11,219	-	(210,417)	2,307,929
Construction in progress	42,598	948,147	-	-	990,745
Total	12,874,697	981,395	-	(266,373)	13,589,719
Less accumulated depreciation:					
Land and land improvements	59,523	15,264	-	(4,750)	70,037
Building	2,220,945	314,124	-	(51,206)	2,483,863
Equipment	1,153,245	202,653	-	(210,417)	1,145,481
Total	3,433,713	532,041	-	(266,373)	3,699,381
Net carrying amount	\$ 9,440,984	\$ 449,354	\$ -	\$ -	\$ 9,890,338

# John Tolfree Health System Corporation

## Notes to Combined Financial Statements March 31, 2005 and 2004

### Note 6 - Property and Equipment (Continued)

Capital asset activity for the year ended March 31, 2004 was as follows:

	Hospital				Depreciable
	2003	Additions	Transfers	Retirements	Life - Years
Land and land improvements	\$ 569,425	\$ -	\$ -	\$ -	5-25
Building	10,008,282	-	-	(316,120)	9-40
Equipment	18,073,171	179,121	1,204,636	(2,096,420)	3-25
Construction in progress	805,841	456,808	(1,204,636)	-	-
Total	29,456,719	635,929	-	(2,412,540)	27,680,108
Less accumulated depreciation:					
Land and land improvements	135,825	38,509	-	-	174,334
Building	1,397,231	337,024	-	(316,120)	1,418,135
Equipment	6,301,222	1,749,159	-	(2,096,420)	5,953,961
Total	7,834,278	2,124,692	-	(2,412,540)	7,546,430
Net carrying amount	\$ 21,622,441	\$ (1,488,763)	\$ -	\$ -	\$ 20,133,678

# John Tolfree Health System Corporation

## Notes to Combined Financial Statements March 31, 2005 and 2004

### Note 6 - Property and Equipment (Continued)

Capital asset activity for the year ended March 31, 2004 was as follows:

	Component Units				Depreciable Life - Years
	2003	Additions	Transfers	Retirements	2004
Land and land improvements	\$ 181,650	\$ 365,571	\$ 82,461	\$ (3,000)	\$ 626,682
Building	9,154,550	1,780	574,093	(32,133)	9,698,290
Equipment	1,537,049	58,287	1,094,117	(182,326)	2,507,127
Construction in progress	1,753,107	40,162	(1,750,671)	-	42,598
Total	12,626,356	465,800	-	(217,459)	12,874,697
Less accumulated depreciation:					
Land and land improvements	53,310	9,213	-	(3,000)	59,523
Building	1,956,869	296,209	-	(32,133)	2,220,945
Equipment	1,148,330	187,241	-	(182,326)	1,153,245
Total	3,158,509	492,663	-	(217,459)	3,433,713
Net carrying amount	\$ 9,467,847	\$ (26,863)	\$ -	\$ -	\$ 9,440,984

# John Tolfree Health System Corporation

## Notes to Combined Financial Statements March 31, 2005 and 2004

### Note 7 - Long-term Debt

Long-term debt activity for the year ended March 31, 2005 was as follows:

	Hospital				
	2004	Current Year Additions	Current Year Reductions	2005	Current Portion
Bonds payable	\$ 14,005,000	\$ -	\$ 395,000	\$ 13,610,000	\$ 415,000
Loan payable	<u>3,617,951</u>	<u>-</u>	<u>84,069</u>	<u>3,533,882</u>	<u>88,012</u>
Total	<u>\$ 17,622,951</u>	<u>\$ -</u>	<u>\$ 479,069</u>	<u>\$ 17,143,882</u>	<u>\$ 503,012</u>

	Component Units				
	2003	Current Year Additions	Current Year Reductions	2004	Current Portion
Note payable	<u>\$ 1,139,256</u>	<u>\$ -</u>	<u>\$ 65,927</u>	<u>\$ 1,073,329</u>	<u>\$ 68,925</u>

Long-term liability activity for the year ended March 31, 2004 was as follows:

	Hospital				
	2003	Current Year Additions	Current Year Reductions	2004	Current Portion
Bonds payable	\$ 14,380,000	\$ -	\$ 375,000	\$ 14,005,000	\$ 395,000
Loan payable	3,699,979	-	82,028	3,617,951	90,533
Total	<u>\$ 18,079,979</u>	<u>\$ -</u>	<u>\$ 457,028</u>	<u>\$ 17,622,951</u>	<u>\$ 485,533</u>

	Component Units				
	2003	Current Year Additions	Current Year Reductions	2004	Current Portion
Note payable	<u>\$ 1,192,063</u>	<u>\$ -</u>	<u>\$ 52,807</u>	<u>\$ 1,139,256</u>	<u>\$ 66,558</u>

- Bonds payable bear interest at fixed rates that vary from 5.3 percent to 6 percent. These bonds are collateralized by virtually all assets of the Hospital. The bonds are due in annual installments ranging from \$415,000 to \$1,145,000.
- Loan payable bears interest at a fixed rate of 4.5 percent, collateralized by virtually all assets of the Hospital and due in monthly installments of \$20,467, including interest.

# John Tolfree Health System Corporation

## Notes to Combined Financial Statements March 31, 2005 and 2004

### Note 7 - Long-term Debt (Continued)

- Note payable to bank bears interest at a fixed rate of 3.5 percent, collateralized by real estate of the Corporation. This loan is due in monthly installments of \$8,775 including interest. Any remaining balance is due in March 2008.

In connection with the bond issues, the Hospital has agreed to various covenants. These covenants include restrictions on additional indebtedness, transfer of assets, and maintenance of certain financial ratios.

The following is a schedule by years of bond principal and interest as of March 31, 2005:

	Hospital		Component Units	
	Principal	Interest	Principal	Interest
2006	\$ 503,012	\$ 961,555	\$ 68,925	\$ 36,374
2007	532,056	935,516	71,377	33,923
2008	551,285	907,308	933,027	31,384
2009	585,709	877,858	-	-
2010	620,335	844,860	-	-
2011-2015	3,638,865	3,661,854	-	-
2016-2020	4,810,915	2,493,486	-	-
2021-2025	5,156,251	922,057	-	-
2026 and after	745,454	29,403	-	-
Total payments	<u>\$ 17,143,882</u>	<u>\$11,633,897</u>	<u>\$ 1,073,329</u>	<u>\$ 101,681</u>

### Note 8 - Deferred Revenue

Deferred revenue relates to a prepaid lease from an area hospital for partial use of a building attached to the Hospital. Under terms of the agreement, the lessee paid for a majority of the construction cost of the building, which the Corporation owns. In exchange, the Corporation issued a 40-year lease. Under terms of the lease agreement, the lessee makes no payments for rental of the building, although payments are made to the Corporation for certain operating costs of the building, such as housekeeping, utilities, and maintenance.

During the years ended March 31, 2005 and 2004, the Hospital recognized \$116,882 in rental income.

# **John Tolfree Health System Corporation**

## **Notes to Combined Financial Statements March 31, 2005 and 2004**

### **Note 9 - Pension Plans**

**Plan Description** - The Corporation maintains a defined benefit retirement plan for all employees who work at least 1,000 hours per year after 30 months of service. Participants under the plan become fully vested after five years of credited service. The plan provides retirement benefits, as well as death and disability benefits. At April 1, 2003, the date of the most recent actuarial valuation, membership consisted of 33 retirees and beneficiaries currently receiving benefits and terminated employees entitled to benefits but not yet receiving them, and 250 current active employees. The plan does not issue a separate financial report.

**Funding Policy** - Plan member contributions are recognized in the period in which the contributions are due. Employer contributions to the plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

The funding policy provides for periodic employer contributions at actuarially determined rates. Administrative costs of the plan are financed through investment earnings. There are no employee contributions.

**Annual Pension Cost** - For the years ended March 31, 2005 and 2004, the Corporation's annual pension cost of \$792,953 and \$754,320, respectively, for the plan was equal to the Hospital's required and actual contribution. The annual required contribution was determined as part of an actuarial valuation of the plan as of April 1, 2003 using the entry age normal cost method. Significant actuarial assumptions used in determining the pension benefit obligation include: (a) a rate of return on the investment of present and future assets of 7 percent per year compounded annually as of April 1, 2003 and 2002 and (b) projected salary increases of 3.5 percent per year compounded annually as of April 1, 2003 and 2002. The unfunded actuarial liability is being amortized as a level percentage of payroll on an open and closed basis. The remaining amortization period is 22 years.



# John Tolfree Health System Corporation

## Notes to Combined Financial Statements March 31, 2005 and 2004

### Note 9 - Pension Plans (Continued)

Three-year trend information:

	Year Ended March 31		
	2005	2004	2003
Annual pension costs	\$ 792,953	\$ 754,320	\$ 528,440
Percent of APC contributed	100%	100%	100%
Actuarial value of assets	*	\$ 8,282,185	\$ 6,478,384
Actuarial accrued liability (entry age)	*	\$ 11,708,454	\$ 10,251,206
Unfunded AAL (UAAL)	*	\$ 3,426,269	\$ 3,772,822
Funded ratio	*	71%	63%
Covered payroll	*	\$ 9,748,321	\$ 8,424,636
UAAL as a percentage of covered payroll	*	35%	45%

\* Information not available

### Note 10 - Risk Management

The Corporation is exposed to various risks of loss related to property loss, errors and omissions, employee injuries (workers' compensation), and professional liability claims as well as medical benefits provided to employees. The Corporation has purchased commercial insurance for the above claims. Settled claims relating to commercial insurance have not exceeded the amount of insurance in any of the past three years.

The Corporation is insured against potential professional liability claims under a claims-made policy, whereby only the claims reported to the insurance carrier during the policy period are covered regardless of when the incident giving rise to the claim occurred. The Corporation bears the risk of the ultimate costs of any individual claims exceeding the policy limits for claims asserted in the policy year. For this contingency, the Corporation has accrued a liability of \$60,865 and \$46,882 at March 31, 2005 and 2004, respectively. The Corporation charged \$50,000 and \$0 against operations during the years ended March 31, 2005 and 2004, respectively.

Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during the claims-made term, but reported subsequently, will be uninsured.

# John Tolfree Health System Corporation

## Notes to Combined Financial Statements March 31, 2005 and 2004

### Note 11 - Component Unit Information

Condensed financial information by individual component unit is as follows

	2005			2004		
	Medical Arts Center	Hospice of Helping Hands, Inc.	Tolfree Foundation	Medical Arts Center	Hospice of Helping Hands, Inc.	Tolfree Foundation
Current Assets	\$ 350,208	\$ 259,521	\$ 60,380	\$ 672,652	\$ 308,360	\$ 57,362
Assets limited as to use	801,899	-	1,279,919	791,325	-	1,228,785
Property and equipment	9,807,339	691	82,308	9,359,454	1,422	80,108
Total assets	<u>\$ 10,959,446</u>	<u>\$ 260,212</u>	<u>\$ 1,422,607</u>	<u>\$ 10,823,431</u>	<u>\$ 309,782</u>	<u>\$ 1,366,255</u>
Current Liabilities	\$ 266,377	\$ 161,861	\$ 13,608	\$ 222,601	\$ 252,751	\$ 6,218
Long-term debt	1,004,404	-	-	1,072,698	-	-
Deferred revenue	3,993,450	-	-	4,110,332	-	-
Total liabilities	5,264,231	161,861	13,608	5,405,631	252,751	6,218
<b>Net Assets</b>						
Invested in capital assets -						
Net of related debt	8,734,010	691	82,308	8,220,198	1,422	80,108
Unrestricted	(3,038,795)	97,660	1,326,691	(2,802,298)	55,609	1,279,929
Total net assets	<u>5,695,215</u>	<u>98,351</u>	<u>1,408,999</u>	<u>5,417,900</u>	<u>57,031</u>	<u>1,360,037</u>
Total liabilities and net assets	<u>\$ 10,959,446</u>	<u>\$ 260,212</u>	<u>\$ 1,422,607</u>	<u>\$ 10,823,531</u>	<u>\$ 309,782</u>	<u>\$ 1,366,255</u>
Operating revenue	\$ 2,598,278	\$ 1,370,956	\$ 72,132	\$ 2,406,898	\$ 990,524	\$ 159,917
Operating expenses	2,297,516	1,407,856	58,564	2,115,833	1,053,571	55,198
Income (loss) from operations	300,762	(36,900)	13,568	291,065	(63,047)	104,719
Nonoperating revenue (expenses)	(23,447)	78,220	35,394	(38,586)	83,348	-
Change in net assets	<u>\$ 277,315</u>	<u>\$ 41,320</u>	<u>\$ 48,962</u>	<u>\$ 252,479</u>	<u>\$ 20,301</u>	<u>\$ 104,719</u>

## **Additional Information**

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To the Board of Trustees  
John Tolfree Health System Corporation

We have audited the basic financial statements of the business-type activities and the aggregate discretely presented component units of John Tolfree Health System Corporation for the years ended March 31, 2005 and 2004. Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The combining information is presented for the purpose of additional analysis of the basic financial statements rather than to present the financial position, results of operations, and cash flows of the individual entities. The information has been subjected to the procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

*Plante & Moran, PLLC*

June 15, 2005

# John Tolfree Health System Corporation

## Combining Balance Sheet March 31, 2005

	John Tolfree Health System Corporation	Medical Arts Center	Hospice of Helping Hands, Inc.	Tolfree Foundation	Eliminations	Total
<b>Assets</b>						
<b>Current Assets</b>						
Cash and cash equivalents	\$ 2,834,220	\$ 72,473	\$ 96,189	\$ 48,069	\$ -	\$ 3,050,951
Accounts receivable	3,801,723	237,245	160,512	-	-	4,199,480
Due from affiliates	281,326	200	-	-	(281,526)	-
Cost report settlements receivable	771,562	-	-	-	-	771,562
Prepaid expenses and other	495,559	40,290	2,820	12,311	-	550,980
Inventories	1,112,043	-	-	-	-	1,112,043
Total current assets	9,296,433	350,208	259,521	60,380	(281,526)	9,685,016
<b>Assets Limited as to Use</b>	5,945,534	801,899	-	1,279,919	-	8,027,352
<b>Property and Equipment</b>	19,031,434	9,807,339	691	82,308	-	28,921,772
<b>Deferred Charges</b>	302,495	-	-	-	-	302,495
Total assets	<b>\$ 34,575,896</b>	<b>\$ 10,959,446</b>	<b>\$ 260,212</b>	<b>\$ 1,422,607</b>	<b>\$ (281,526)</b>	<b>\$ 46,936,635</b>
<b>Liabilities and Net Assets</b>						
<b>Current Liabilities</b>						
Current portion of long-term debt	\$ 503,012	\$ 68,925	\$ -	\$ -	\$ -	\$ 571,937
Accounts payable	1,999,343	40,962	28,220	-	-	2,068,525
Due to affiliates	200	156,490	111,228	13,608	(281,526)	-
Accrued expenses	1,676,013	-	22,413	-	-	1,698,426
Total current liabilities	4,178,568	266,377	161,861	13,608	(281,526)	4,338,888
<b>Long-term Debt</b>	16,640,870	1,004,404	-	-	-	17,645,274
<b>Deferred Revenue</b>	-	3,993,450	-	-	-	3,993,450
Total liabilities	20,819,438	5,264,231	161,861	13,608	(281,526)	25,977,612
<b>Net Assets</b>						
Invested in capital assets - Net of related debt	1,887,552	8,734,010	691	82,308	-	10,704,561
Unrestricted	11,868,906	(3,038,795)	97,660	1,326,691	-	10,254,462
Total net assets	13,756,458	5,695,215	98,351	1,408,999	-	20,959,023
Total liabilities and net assets	<b>\$ 34,575,896</b>	<b>\$ 10,959,446</b>	<b>\$ 260,212</b>	<b>\$ 1,422,607</b>	<b>\$ (281,526)</b>	<b>\$ 46,936,635</b>

# John Tolfree Health System Corporation

## Combining Statement of Revenue, Expenses, and Changes in Net Assets Year Ended March 31, 2005

	John Tolfree Health System Corporation	Medical Arts Center	Hospice of Helping Hands, Inc.	Tolfree Foundation	Eliminations	Total
<b>Operating Revenue</b>						
Net patient service revenue	\$ 36,900,285	\$ 1,139,362	\$ 1,370,956	\$ -	\$ (409,010)	\$ 39,001,593
Other operating revenue	741,968	1,458,916	-	72,132	(313,521)	1,959,495
Total operating revenue	37,642,253	2,598,278	1,370,956	72,132	(722,531)	40,961,088
<b>Operating Expenses</b>						
Salaries and wages	12,491,357	575,223	495,081	20,496	-	13,582,157
Fringe benefits	4,569,338	207,656	159,345	7,399	-	4,943,738
Supplies and other	10,941,581	510,233	555,925	30,669	(313,521)	11,724,887
Drugs	4,599,301	-	105,150	-	-	4,704,451
Professional fees	3,284,310	473,094	91,624	-	(409,010)	3,440,018
Depreciation and amortization	1,930,905	531,310	731	-	-	2,462,946
Total operating expenses	37,816,792	2,297,516	1,407,856	58,564	(722,531)	40,858,197
<b>Income (Loss) from Operations</b>	(174,539)	300,762	(36,900)	13,568	-	102,891
<b>Nonoperating Revenue (Expense)</b>						
Investment income	141,782	15,926	516	35,394	-	193,618
Unrestricted donations	12,898	-	77,704	-	-	90,602
Interest expense	(975,003)	(39,373)	-	-	-	(1,014,376)
Net nonoperating revenue (expense)	(820,323)	(23,447)	78,220	35,394	-	(730,156)
<b>Increase (Decrease) in Net Assets</b>	(994,862)	277,315	41,320	48,962	-	(627,265)
<b>Net Assets - Beginning of year</b>	14,751,320	5,417,900	57,031	1,360,037	-	21,586,288
<b>Net Assets - End of year</b>	\$ 13,756,458	\$ 5,695,215	\$ 98,351	\$ 1,408,999	\$ -	\$ 20,959,023

Report on Internal Control Over Financial Reporting and on  
Compliance and Other Matters Based on an Audit of Financial  
Statements Performed in Accordance with *Government Auditing Standards*

To the Board of Trustees  
John Tolfree Health System Corporation

We have audited the financial statements of John Tolfree Health System Corporation as of and for the year ended March 31, 2005, and have issued our report thereon dated June 15, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control over Financial Reporting**

In planning and performing our audit, we considered John Tolfree Health System Corporation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether John Tolfree Health System Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

To the Board of Trustees  
John Tolfree Health System Corporation

We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to the management of John Tolfree Health System Corporation in a separate letter dated June 15, 2005.

This report is intended solely for the information and use of the board of trustees, management, and federal awarding agencies and is not intended to be, and should not be, used by anyone other than these specified parties.

*Plante & Moran, PLLC*

June 15, 2005



July 25, 2005

Board of Trustees

John Tolfree Health System Corporation and Subsidiaries

In planning and performing our audit of the financial statements of John Tolfree Health System Corporation and Subsidiaries for the year ended March 31, 2005, we considered the Corporation's internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. The consideration we gave to the internal control structure was not sufficient for us to provide any form of assurance on it. However, we noted certain matters involving the internal control structure and its operation where we feel opportunities for improvement exist, as well as some additional areas for Board consideration.

This report contains our observations, comments, and other items we feel warrant your consideration. All items are presented for your consideration on attachments as outlined below:

TITLE	EXHIBIT
GASB Update	A
Highlights of the OIG's 2005 Work Plan	B
Corporate Compliance Update	C
Developing a HIPAA Contingency Plan	D

The report is intended solely for the information and use of the Board of Trustees, management, and others within the Hospital. Please call us if we can help on implementing any of the above recommendations.

Sincerely,

**PLANTE & MORAN, PLLC**



Michael A. Baker, CPA  
Partner

**John Tolfree Health System Corporation and Subsidiaries**  
**Exhibit A**  
**GASB Update**

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The Government Accounting Standards Board (GASB) has recently released the following new pronouncements that will have a direct impact on the financial statements of the Corporation:

- GASB Statement No. 40 - *Deposit and Investment Risk Disclosures*
- GASB Statement No. 45 - *Accounting and Reporting by Employers for Postemployment Benefits Other Than Pensions*

GASB Statement No. 40 will be applicable for the year ended March 31, 2006 and will require additional disclosures in the financial statements regarding risk related to deposits and investments held by the Corporation. These risks include credit risk, concentration of credit risk, interest rate risk, and foreign currency risk.

GASB Statement No. 45 provides guidance for local units of government in recognizing the cost of retiree healthcare, as well as any "other" postemployment benefits (other than pensions). The intent of the new rules is to recognize the cost of providing retiree healthcare coverage over the working life of the employee, rather than at the time the healthcare premiums are paid.

The new pronouncement will require a valuation of the obligation to provide retiree healthcare benefits, including an amortization of the past service cost over a period of up to 30 years. The valuation must include an annual recommended contribution (ARC). While the ARC does not need to be funded each year, any under funding must be reported as a liability on the statement of net assets.

This valuation will need to be performed by an actuary if the total participants exceed 100. Participants are defined as employees in active service, terminated employees not yet receiving benefits, plus retirees and beneficiaries currently receiving benefits. For plans with 100 to 200 participants, the actuarial valuation must be at least every three years; for those over 200 participants, at least every other year.

This statement will be effective for the year ended March 31, 2009. The planning to make the annual recommended contribution generally requires from three to six months for an actuarial valuation plus six months lead time to work the numbers into the budget. Therefore, we recommend that you begin the actuarial valuation at least one year prior to the above date.

**John Tolfree Health System Corporation and Subsidiaries**  
**Exhibit B**

**Highlights of the OIG's 2005 Work Plan**

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The 2005 Work Plan issued by the Office of the Inspector General (OIG) identifies projects that have evolved in response to new issues and the shifting priorities of Congress. The OIG spends significant resources in the investigation of fraud and misconduct committed against the Medicare and Medicaid programs.

Highlights from the OIG's 2005 Work Plan include, but are not limited to:

**Rebates Paid to Hospitals** – OIG will determine whether hospitals are properly identifying purchase credits as a separate line item in their Medicare cost reports. This will be done through visiting several large vendors and determining the amount of rebates paid to hospitals in a given year, and then examining a sample of cost reports to determine if the rebates were properly credited.

**Outpatient Cardiac Rehab Services** – OIG will determine whether cardiac rehab services provided by hospital outpatient departments meet Medicare coverage requirements. Medicare covers such rehab under the "incident-to" a physician's professional services benefit, which requires that the services of non-physician personnel be furnished under the physician's direct supervision.

**Lifetime Reserve Days** – OIG will determine how hospitals comply with the current requirement to notify Medicare beneficiaries about the use of lifetime reserve days and also assess the appropriateness and feasibility of providing an additional notification prior to a beneficiary's exhaustion of them. Medicare beneficiaries are entitled to an unlimited number of 90-day episodes of care. They may also extend their inpatient benefit by up to a lifetime total of 60 days. These are called lifetime reserve days; they are not renewable.

**Physicians - Coding of Evaluation and Management (E&M) Services** – OIG will examine patterns of physician coding of E&M services and determine whether these services were coded accurately. In 2003, Medicare allowed over \$29 billion for E&M services. In prior work, the OIG has found that a significant portion of certain categories of these services were billed with incorrect codes resulting in large overpayments.

**Physicians - Use of Modifier 25** – In general, a provider should not bill E&M codes on the same day as a procedure or other service unless the E&M service is a significant, separately identifiable service from such procedure or service. OIG will determine whether providers use modifier 25 appropriately.

**John Tolfree Health System Corporation and Subsidiaries**  
**Exhibit C**  
**Corporate Compliance Update**

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The Office of the Inspector General (OIG) recently issued its Supplemental Compliance Program Guidance for Hospitals (CPG). The full text of this notice is contained in Federal Register Notice 70 FR 4858 dated January 31, 2005. Through this notice, the OIG is supplementing its prior compliance program guidance for hospitals issued in 1998. The supplemental CPG contains new compliance recommendations and an expanded discussion of risk areas, taking into account recent changes to hospital payment systems and regulations, evolving industry practices, current enforcement priorities, and lessons learned in the area of corporate compliance. The supplemental CPG provides voluntary guidelines to assist hospitals and hospital systems in identifying significant risk areas and in evaluating and, as necessary, refining ongoing compliance efforts.

Realizing the diversity of the hospital industry, the OIG's CPG does not provide a "one-size-fits-all" guidance, but rather encourages hospitals to identify and focus their compliance plans and efforts on areas of potential concern and risk that are the most relevant to their individual organizations and to the delivery of healthcare in general.

The OIG explained that hospitals may gain important information by voluntarily implementing a compliance program that includes:

1. A demonstration of the hospital's commitment to honest and responsible corporate conduct.
2. A plan of increasing the likelihood of preventing, identifying and correcting unlawful and unethical behavior at an early stage.
3. A method of encouraging employees to report potential problems to allow for appropriate internal inquiry and corrective action.
4. A plan that, through early detection and reporting, minimizes any financial loss to government and taxpayers, as well as any corresponding financial loss to the hospital.

The supplemental CPG also indicates several areas that the OIG considers ripe for fraudulent activity. Outpatient bill coding, due to its complexity with both prospective payment system codes and ambulatory payment classification codes, especially concerns the OIG. Improper coding and billing for "same-day" discharges and readmissions, and improper claims for pass-through drugs, outlier payments, and provider-based services are also new problem areas.

We commend the Organization on its efforts to support and monitor corporate compliance activities. We do, however, strongly encourage the Organization to thoroughly review the new Supplemental Compliance Program Guidance and incorporate it into the existing plan and activities.

**John Tolfree Health System Corporation and Subsidiaries**  
**Exhibit D**  
**Developing a HIPAA Contingency Plan**

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Computer systems are never 100 percent reliable. They can crash, making data difficult, if not impossible, to recover. Under the HIPAA Security Rule healthcare organizations must develop a data backup plan. Covered entities must start complying with the Security Rule in April of this year. Healthcare organizations must establish and implement procedures to create and maintain retrievable exact copies of electronic protected health information (PHI) and backup data on a regular basis. Electronic PHI should not be interpreted as being just electronic medical records, but also includes all patient information maintained on a computerized system, including scheduling, medications, lab results, etc. Organizations must also establish, and implement as needed, procedures to restore any lost data in the case of any disaster.

HIPAA also requires covered entities to implement an emergency mode operation plan containing procedures that enable them to continue critical business processes that protect the security of electronic PHI. This may be as simple as maintaining paper records until the emergency situation is over. Contingency plans need to be tested and revised regularly. Initially, testing should be done in sections or functional areas and during nonoperating hours.

Covered entities also need to review and document the relative importance of all hardware and software applications. For example, if a covered entity uses two applications, one for scheduling and one for accessing certain electronic PHI, it should consider which one is more critical or important to restore first in the event of an emergency. The order of priority will be very important in creating the detailed backup, disaster recovery, and emergency mode operations.

Establishing procedures that allow support personnel to get into the facility and restore lost data in the event of an emergency is also crucial. This will help ensure those needing access in an emergency have access, including any individuals who normally do not have access to the covered entity's electronic information.

The primary objectives of a disaster recovery plan are to protect the organization in the event that all or part of its operations and/or computer services are rendered unusable, minimize disruption of operations, and ensure some level of organizational stability and orderly recovery after a disaster. Moreover, a disaster recovery plan provides a sense of security, minimizes the risk of delays, guarantees the reliability of standby and secondary systems and processes, establishes a standard plan for testing, and minimizes decision making during a disaster.

We recommend that the Organization review any contingency plans currently in place and ensure that the HIPAA requirements are covered.